COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

The Berkshire Gas Company	)	D.T.E. 04-47

INITIAL BRIEF OF
THE BERKSHIRE GAS COMPANY

I. OVERVIEW

On April 27, 2004, The Berkshire Gas Company ("Berkshire" or the "Company") filed a petition pursuant to G.L. c. 164, §76 and §94A for approval by the Department of Telecommunications and Energy (the "Department") of: (i) the Gas Portfolio Optimization Agreement between the Company and BP Energy Company ("BP Energy") dated as of March 22, 2004 (the "Portfolio Agreement"); and (ii) the Gas Sales and Purchase Agreement between the Company and BP Energy dated as of March 22, 2004 (the "Purchase Agreement"; the Purchase Agreement and the Portfolio Agreement are referred to collectively as the "Agreements"). The Agreements extend and modify the terms of an "alliance" structure pursuant to which Berkshire shall continue to pursue a variety of opportunities to secure gas cost savings for the benefit of its customers. The alliance was originally established pursuant to a Gas Portfolio Optimization Agreement dated March 30, 2001 and a Gas Sales and Purchase Agreement dated March 30, 2001 between the Company and BP Energy (the "2001 Agreements"). The 2001 Agreements were approved by the Department in The Berkshire Gas Company, D.T.E. 01-41 (June 29, 2002). Thereafter, the alliance structure was extended for a two-year term commencing April 1, 2002 pursuant to a Gas Portfolio Optimization Agreement dated March 25, 2002 and a Gas Sales and Purchase Agreement dated March 25, 2002 between the Company and BP Energy (the "2002 Agreements"). The 2002 Agreements were approved by the Department in The Berkshire Gas Company, D.T.E. 02-19 (September 30, 2002).

The Agreements preserve the fundamental structure of the twice-approved alliance arrangement. Exh. BG-1, pp. 3-4. First, Berkshire shall continue to control and manage its existing and approved gas supply, transportation and storage resources, seeking to build upon its increasing experience in managing its resources to generate gas cost savings for the benefit of its customers. Second, Berkshire shall continue work with its affiliated local distribution companies New York State Electric & Gas Corporation ("NYSEG"), Connecticut Natural Gas Corporation ("CNG"), The Southern Connecticut Gas Company ("SCG") and, now, for the first time, Rochester Gas and Electric Corporation ("RG&E"; NYSEG, CNG, SCG and RG&E are referred to collectively as the "LDCs") to generate savings that have been made available by mergers involving Energy East Corporation. Finally, Berkshire and the LDCs have agreed to continue to work with BP Energy to pursue additional value through transactions that may be generated or identified by BP Energy or through the application of BP Energy's substantial expertise and resources. Id. at 4. The alliance team will continue to coordinate their activities in an attempt to optimize or manage the combined portfolios and to build upon the achievements of the initial alliance term. Id. Importantly, a detailed audit analysis of performance under the 2002 Agreements confirmed that the alliance's procedures and controls are "reasonable and are functioning as intended." Exh. DTE-1-25 (Supp.).

NYSEG, CNG, SCG and RG&E executed agreements with BP Energy that are substantially identical to the Portfolio Agreement and the Purchase Agreement. Exh. BG-1, p. 3; Exh. AG-19.[1] The term of the Agreements is for the period between April 1, 2004 through March 31, 2007.[2]

Finally, the Company has properly requested that margins generated through the alliance structure be eligible for sharing pursuant to the procedures established in Interruptible Transportation, D.P.U. 93-141-A (1996). The Company demonstrated that transactions pursued within the alliance structure will be applied in a manner consistent with that standard and other relevant Department precedent. The Company has also explained how the failure to apply such principles will inappropriately and unfairly penalize the Company in its efforts to maximize optimization results through a more aggressive approach. In sum, the Company demonstrated that its proposal to share optimization margins was appropriate, fair and consistent with established Department standards.

II. PROCEDURAL HISTORY

Subsequent to the filing of the Company's petition, the Attorney General of the Commonwealth (the "Attorney General") filed notice of his intervention and NSTAR Gas Company filed a petition to participate in this proceeding as a limited participant. The Department conducted a public hearing at its offices on July 23, 2004. At this public hearing, NSTAR's petition for limited participant status was granted and the parties

[1] Berkshire also executed an interim agreement (and an extension with respect to the timing of regulatory approval) with BP Energy to cover the period from April 1, 2004 through October 31, 2004. Exh. AG-1-22 (Att. A); Exh. AG-1-3.

[2] Several ancillary agreements were executed in connection with the alliance documents, including an Allocation Agreement that memorialized the procedures to be employed in terms of the allocation of savings generated within the alliance among the Company and the LDCs. See Exh. BG-3, Exhibit B-10; Exh. AG-1-5. A Netting Agreement was also executed that memorializes certain payment or settlement procedures. Id. at Exhibit B-9. These ancillary agreements were included within the Portfolio Agreement.

discussed a procedural schedule. The Hearing Officer later established a procedural schedule and ground rules in a memorandum dated July 26, 2004. An evidentiary hearing was held at the Department's offices on September 9, 2004. At the evidentiary hearing, the Company presented the testimony of Karen L. Zink, President, Chief Operating Officer and Treasurer of the Company.

The evidentiary record consists of numerous documentary exhibits, including the initial filing of the Agreements, prepared testimony of Ms. Zink and the Company's responses to information and record requests, as well as the sworn testimony presented at the hearing. The established procedural schedule required the filing of initial briefs on September 24, 2004. Reply briefs were directed to be filed on October 1, 2004. The Company requested that a decision be issued by October 31, 2004 so that the Company could enter the winter season with some certainty as to its portfolio optimization procedures. Tr. 8-12.[3]

III. THE RFP PROCESS SATISFIED RELEVANT DEPARTMENT STANDARDS

Berkshire has demonstrated that the Agreements are the product of its continuing and diligent effort to provide reliable, least-cost service to customers, including the issuance of appropriate competitive solicitations to secure beneficial resources and services. As the Department has noted, local distribution companies are

[3] The Company sought confidential treatment for portions of the Agreements, for a number of documentary exhibits and for portions of the evidentiary hearings that addressed competitively sensitive issues. The Company filed a motion for protected treatment with respect to the Agreements that was referenced in subsequent filings. A hearing officer ruling dated September 8, 2004 granted the Company's initial request. The Company has also sought similar treatment for other materials. The Company notes that its continuing ability to secure innovative and competitive bids for gas and gas-related services is dependent upon the confidence of bidders that competitively sensitive materials will be accorded confidential treatment. In addition, the Company executed confidentiality agreements with bidders to the Joint RFP and, therefore, has a contractual obligation with respect to such matters. The Company also executed a confidentiality agreement with the Attorney General with respect to this proceeding. The Company will not restate its arguments with respect to confidentiality in this brief. The Company notes its appreciation for the efforts of Department staff and the Attorney General to protect the competitively sensitive portions of the Agreements and the evidentiary record.

under a continuing obligation to seek ways in which to optimize the value of their gas supply resources and to minimize the cost of those resources for customers. NOI-Gas Unbundling, D.T.E. 98-32-B, pp. 58-59. Over the last several years, Berkshire has pursued a variety of techniques in order to secure value and to reduce the cost of gas service for customers. These efforts included individual, limited term arrangements and the execution of an asset management contract that was approved by the Department in Berkshire Gas Company, D.T.E. 99-81 (1999). In early 2001 Berkshire built upon its substantial, direct experience with a variety of optimization alternatives and, at the same time, evaluated the gas resource synergies that were available because of the then recent mergers with Energy East. The combined resource portfolios of Berkshire and the LDCs (except RG&E which had not yet merged with Energy East) were evaluated and opportunities to lower costs or extract value were identified and considered. The expanded resources available because of such mergers made a wider range of savings or management opportunities available to the Company because of the more substantial internal expertise and the greater value that a larger, more diverse portfolio and geographically expansive service area provided. Cf. Boston Gas Company, et. al., D.T.E. 99-76, pp. 20-21 (1999). The Department also found that this early 2001 solicitation that resulted in the execution of the 2001 Agreements was transparent, fair and open. Berkshire Gas, D.T.E. 01-41, p. 11.

In fact, Berkshire has continually sought to refine the solicitation process for optimization and apply the experience gained from prior solicitations for the benefit of its customers. For example, near the end of the term of the 2001 Agreements, Berkshire worked with the LDCs (including RG&E)[4] to refine and implement a fair, open and transparent competitive bidding process that was intended to secure proposals that would provide the greatest value to customers. These efforts ultimately culminated in the issuance of a request for proposals for optimization services for Berkshire and the LDCs in late 2001 (the "2001 Joint RFP"). Berkshire determined that such a robust combined solicitation was the best means to test the market to ensure that the most attractive proposal was pursued and to comply with Department precedent. Exh. BG-1, pp. 7-8; Berkshire Gas, D.T.E. 01-41, pp. 10-11; Berkshire Gas, D.T.E. 99-81, pp. 3-5; Boston Gas, D.T.E. 99-76, pp. 20-2.[5] The 2001 Joint RFP and the related evaluation process were similar to the RFP and evaluation process that resulted in the 2001 Agreements.

Similar to prior, approved joint solicitation processes with the LDC's, in late 2003 the Company and the LDC's began a process to evaluate potential options to replace the service provided pursuant to the 2002 Agreements. The Company was again benefited from its substantial prior experience in this area. Exh. BG-1, pp. 7-8. These joint efforts to develop and implement a process to secure the greatest value for

[4] At the time, RGS Energy Group, Inc., the parent of RG&E had executed an agreement to merge with Energy East Corporation. In the 2002 solicitation, RG&E ultimately elected to choose another energy supplier.

[5] The 2001 Agreements included a provision whereby the term of the alliance could be extended beyond the initial one-year term upon such modified terms and conditions to be developed during an "exclusive" negotiation period with BP Energy. See Berkshire Gas, D.T.E. 01-41, pp. 13-14. The Department's order in D.T.E. 01-41 directed that, prior to renewing the 2001 Agreements for a consecutive term, the Company should "issue a new RFP and . . . demonstrate to the Department that renewing the [2001 Agreements] would likely produce benefits to Berkshire that would equal or exceed other marketing offerings." Id. at 14. Prior to the issuance of the Joint RFP, Berkshire, in fact, issued its own request for proposals ("Berkshire RFP") to secure Company-specific bids so that it might fully evaluate the merits of extending the alliance and comply with the Department's directives. Berkshire Gas, D.T.E. 02-19, pp. 10-11. Berkshire and the LDCs elected to terminate "renewal" negotiations with BP Energy with respect to continuing the alliance under the 2001 Agreements and issued the Joint RFP.

The Company nevertheless found the responses to the Berkshire RFP to be informative. The Company noted the limited number of responses to the Berkshire RFP and the disappointing proposals within such responses. Berkshire Gas, D.T.E. 02-19, pp. 9-10. Berkshire recognized that these limited bids reflected not only the changed market conditions but also the more limited value of the Company's resources on a "stand-alone" basis. Id. This experience was the basis for the Company's decision to participate in the Joint RFP process resulting in the execution of the Agreements. Exh. DTE-1-18.

customers resulted in the issuance of a Request for Proposal, The Energy East Companies dated November 14, 2003 (the "2003 Joint RFP"). Sixteen potential bidders were issued the 2003 Joint RFP. Exh. AG-1-19 (Att. I). Eleven bids were received and analyzed in detail and certain clarifications and enhancements were requested and secured. Id. at Att. D, Att. G; Exh. BG-1, p. 8. The nature of the solicitation was clear, potential bidders were afforded the opportunity to ask questions on the RFP and no bidders raised procedural or substantive complaints with the process. Exh. DTE-1-19; Exh. AG-1-19 (Att. C). The responses to the 2003 Joint RFP reflected then current market conditions.

A comprehensive quantitative and qualitative evaluation was completed and detailed negotiations commenced with the proponents of the most favorable bids. Exh. BG-1, p. 8; Exh. AG. 1-20. Enhanced proposals were eventually secured from these most favorable bidders. The Department has previously endorsed gas company resource acquisition processes such as this involving the solicitation of competitive bids from alternative suppliers. Berkshire Gas Company, D.T.E. 98-110, p. 7 (1999); Colonial Gas Company, D.P.U. 96-48, pl 49 (1996); Holyoke Gas and Electric Light Department, D.P.U. 93-191, p. 30 (1996); Blackstone Gas Company, D.P.U. 95-15, p. 17 (1996); Fall River Gas Company, D.P.U. 94-38, p. 10 (1995). More specifically, the Department has approved and endorsed very similar solicitation processes in Berkshire Gas, D.T.E. 01-41 and Berkshire Gas, D.T.E. 02-19.

The Company and the LDCs properly determined that the BP Energy proposal was superior to alternative proposals. The BP Energy proposal, as enhanced, presented the best opportunity for the Company to manage its resources in order to reduce gas costs for customers. Exh. BG-1, pp. 8-9; Tr. 147-49. Specifically, the

Company recognized that the alliance provided substantial benefits in a range of market conditions. First, when gas prices are low and stable (and optimization opportunities are less available), the alliance provides for a significant guaranteed minimum savings payment. Alternatively, when commodity prices are higher and more volatile (and optimization or capacity management opportunities are more readily available), the alliance will continue to provide strong incentives to maximize savings with the Company and the LDCs receiving the benefit of nearly all savings generated through the alliance. Exh. BG-3, Art. III; Exh. BG-1. pp. 9-10. (The Company and the LDCs "are guaranteed an aggregate minimum level of savings. . . with [the Company and] the LDCs retaining most of the upside."). Importantly, when the benefits of capacity management or optimization are most necessary, the alliance has been structured to place no limit on the savings to customers. Cf. Berkshire Gas, D.T.E. 02-19, p. 14.

Alternative proposals were simply not as attractive. Generally, alternative bids did not compare favorably in terms of price. Also, the consideration of non-price factors supported the BP Energy proposal. Exh. AG-1-26; Exh. AG-1-37. Exh. AG-19, Att. I; Exh. BG-1, p. 8; cf. KeySpan Energy Delivery New England, D.T.E. 02-18 (2002). BP Energy, unlike many other players in the natural gas market, continues to maintain a strong credit rating. Exh. AG-1-42. In addition, the alliance structure continues to avoid the operational and control-related concerns associated with the insolvency or bankruptcy of an asset manager, a continuing concern in the rapidly changing natural gas marketplace. Cf. Exh. DTE-1-27. Indeed, even when compared to the next most favorable bid, the BP Energy proposal was superior for all categories except for one attribute that was less significant in terms of benefits to customers.[6]

In addition, the Company and the LDCs recognized that a strong working relationship with BP Energy had been developed and that appropriate systems and controls had been established to ensure that alliance savings were calculated and allocated properly. See, e.g. Exh. DTE-1-6. Indeed, a second detailed audit process of the alliance structure, described below, confirmed the appropriateness of the alliance's procedures and controls. Exh. DTE-1-25 (Supp.); see also Berkshire Gas, D.T.E. 02-19, p. 15. The fact that the alliance has established and maintained appropriate procedures and controls during its initial terms provides the Company substantial comfort with respect to future operations pursuant to the Agreements.

In sum, the Joint RFP and the Company's evaluation and negotiation processes were substantially similar to the procedures followed and approved with respect to the initial alliance documents. The RFP process was transparent and fair and resulted in the selection of the most beneficial provider of optimization services. Accordingly, the Department should find that the Agreements were the product of a fair, open and transparent RFP process consistent with the requirements of D.T.E. 98-32 and other Department precedent. Berkshire Gas, D.T.E. 01-41, p. 11; Berkshire Gas, D.T.E. 02-19, pp. 10-11; NOI - Gas Unbundling, D.T.E. 98-32-B, p. 55; Berkshire Gas, D.T.E. 99-81, pp. 3-4; Boston Gas, D.T.E. 99-76, pp. 20-21; Colonial Gas, D.P.U. 96-48, p. 49.

[6] Ms. Zink explained that while BP Energy received a lower score on that particular attribute, its performance was nevertheless excellent. Moreover, BP Energy had tentative plans to make internal enhancements for this attribute. Tr. 168; Exh. AG-2-7; Exh. BG-3, Art. 2.8.

IV. **THE AGREEMENTS ARE CONSISTENT WITH BERKSHIRE'S STATUTORY OBLIGATIONS AND DEPARTMENT PRECEDENT**

A. Description of the Agreements

The Portfolio Agreement implements the continuation of an innovative approach to gas supply and procurement that imposes no additional risk on the Company or its customers. Exh. BG-3, Art. XII; Exh. AG-1-64; Cf. Berkshire Gas, D.T.E. 01-41, pp. 11-12; Berkshire Gas, D.T.E. 02-19, p. 16; and Boston Gas, D.T.E. 99-76, pp. 20-21. The Portfolio Agreement provides for the continuation of the approved strategic alliance pursuant to which BP Energy will continue to consult with and assist the Company in the cost-effective utilization of the Company's natural gas supply, transportation and storage assets, and advise the Company on matters involving price risk management and market conditions. Exh. BG-1, pp. 5, 9; Exh. BG-3, Art. II; Exh. DTE-1-9. As noted, the Agreements provide the greatest opportunity for the generation of overall gas cost savings by exploiting the opportunities available through coordinated activities with affiliates and the substantial resources available through BP Energy. Exh. AG-1-19 (Att. I). The Portfolio Agreement ultimately maintained the refined incentive structure that achieves the Company's established objectives and continues to align the interests of all the alliance parties. Exh. BG-3, Art. IV. That is, maximum benefits for each party are achieved only when particular transactions also secure the maximum benefits for the other party.[7] Importantly, and consistent with Department precedent, the Agreements also provide for enhanced document maintenance procedures beyond those generally found to be acceptable after a detailed audit. See Exh. AG-1-22 (Att. A); Exh. DTE-1-25 (Supp.) (Operating Procedures enhanced from 2002 Agreements).

[7] Changes to the guaranteed minimum from the 2002 Agreements relate more to the relative contribution of Berkshire as a result of adding another party, RG&E, to the alliance. Tr. 92-93; Exh. AG-2-4.

Given the strong procedures already in place as confirmed by detailed and rigorous audits, the Department should draw substantial comfort from these enhancements.

The Company's Portfolio Agreement with BP Energy is designed to continue to produce additional savings over and above those levels achievable by the Company without BP Energy. Cf. Berkshire Gas, D.T.E. 01-41, pp. 11-12; Berkshire Gas, D.T.E. 02-19, p. 16. Under this alliance, BP Energy will use its expertise, supplies, and financial tools to add value to the Company's transactions.[8] BP Energy will assist the Company in optimizing its assets with the goals of reducing the commodity cost of gas and achieving least-cost routing. Exh. BG-1; p. 9. The Company may continue to purchase its Gulf of Mexico supplies from alternative suppliers and has negotiated out a prior right of BP Energy to match competing offers. Exh. BG-1, p. 10; Exh. BG-3, Art. 2.7; Exh. AG-1-23; Exh. AG-1-27. Importantly, access to BP Energy's broad expertise and market knowledge will continue to assist the Company with respect to decisions related to reducing the commodity cost of gas. Exh. BG-1, p. 9; Exh. BG-3, Exhibit B-2; see also Exh. AG-1-4 and Exh. AG-1-31 for summary of result of alliance efforts to achieve savings.

BP Energy and the Company will continue to work together on a daily basis to further reduce commodity costs associated with delivery of gas volumes, storage fill, and transportation, while maintaining the level of reliability. See e.g. Exh. BG-3, Art. II; Exh. DTE-1-9; Exh. BG-3, Exhibit B-2. Importantly, Berkshire will retain control over its resources and remains committed to satisfying its mandate to provide reliable, least-cost service. See, e.g., Exh. BG-1, Art. 2.9. Berkshire will continue to

[8] The three-year term may facilitate additional management opportunities by permitting specific optimization strategies that extend for more substantial periods, i.e. longer than one year. Exh. BG-1, p. 4; Exh. AG-1-29.

participate in daily discussions with alliance team members and continue to dispatch its resources based upon the best available information and internal planning. Exh. DTE-1-6. Optimization or capacity management opportunities will continue to be identified and exploited through the combined expertise of BP Energy and the Company, and the use of the assets of BP Energy and the Company, to improve overall gas cost savings for the Company. Exh. BG-1, p. 9; Exh. AG-1-22 (Att. B); Exh. BG-3, Exhibit B-2. The Company has also structured the Portfolio Agreement to maintain an appropriate guaranteed aggregate minimum benefit while also ensuring that BP Energy has a strong incentive to enhance the value of the Company's portfolios. Thus, even if no savings are realized, BP Energy will make guaranteed payments to the Company and the LDCs under the Portfolio Agreement, and the Company will only pay BP Energy for the commodity cost of the gas purchased by the Company. Exh. BG-1, p. 9; Exh. BG-3, Art. IV; see also Berkshire Gas, D.T.E. 02-19, p. 17, n. 13. This structure will ensure that BP Energy continues to maintain appropriate incentives to maximize the Company's savings and help the Company to obtain natural gas at the lowest possible cost.

Under the Portfolio Agreement, the "commodity cost of gas" will be determined by utilizing least-cost routing of the gas and will rely upon production area indices, pre-existing contract prices, and actual pipeline variable costs to determine the delivered-to-citygate commodity cost of gas. Exh. BG-3, Exhibit B-2. In addition, the Company will have full access to gas storage to withdraw gas that has been injected at summer prices. Exh. AG-1-22 (Att. B); Exh. DTE-1-9. These approaches will allow the Company to continue to optimize or manage its purchasing decisions and take advantage of market price differentials. Indeed, these same techniques proved extremely effective during the initial terms of the alliance securing substantial savings despite market and weather conditions that reduced the opportunities for optimization transactions. See, e.g. Tr. 22; Exh. BG-1, p. 5.

The Company's experience with BP Energy for the past three years has also confirmed the merits of continuing the alliance. First, BP Energy's operational performance has been exemplary. Exh. BG-1, p. 5; Exh. AG-1-4; Exh. AG-1-31. Second, the savings achieved during this initial period have been greater than the level of savings the Company could have expected to achieve under the relevant market conditions absent this alliance with BP Energy. Id. Again, market and weather conditions made optimization opportunities more difficult. Exh. BG-1, p. 5. The alliance, however, will provide benefits to the Company's customers under a range of market conditions. Thus, at a minimum, the alliance can be expected to provide "low case" benefits consistent with or superior to alternatives considered in response to the Joint RFP, while preserving the "upside" for the benefit of the Company's customers. This flexibility confirms the merits of the alliance structure. Indeed, this overall contribution to the Company's resource plan (even under the most unfavorable optimization conditions) was specifically acknowledged by the Department. Berkshire Gas, D.T.E. 02-19, p. 17, n. 13.

The Company's collective savings realized by this strategic alliance with BP Energy will be determined in accordance with §4.2 of the Portfolio Agreement (Exh. BG-3) as clarified in the Allocation Agreement among the Company and the LDCs. Exh. BG-3, Exhibit B-10. BP Energy will maintain, and the Company will have full access to, the record of all transactions entered into under the Portfolio Agreement. Exh. BG-3, §2.3; Exh. AG-1-22 (Att. B); Exh. AG-1-50. All transactions will be recorded at the date of execution and such information will be available to Berkshire in "real time." Exh. AG-

1-22 (Att. B). Enhanced reporting and analysis requirements have been reflected in the Portfolio Agreement. Exh. BG-3, Exhibit B-11. As confirmed in the Allocation Agreement, the Company's and each of the LDCs' individual share of the savings realized under the Portfolio Agreements will be, to the "maximum extent practicable," allocated to each company individually on a transaction-by-transaction basis. Exh. B-3, Exhibit B-10, p. 2; Exh. AG-2-3; Berkshire Gas, D.T.E. 02-19, pp. 17-18. The "allocation team" process has been refined and will continue to provide for the timely and well-documented applications allocation procedures to ensure that appropriate savings dollars continue to flow to the Company. Exh. AG-1-65; Exh. AG-1-66; Exh. AG-1-66 (Supp.). The allocation team will analyze each transaction and allocate savings based upon the nature of the transaction.

The related Purchase Agreement executed with BP Energy provides Berkshire with a least-cost, reliable and still more flexible resource and enables Berkshire to "fine tune" its supply portfolio to continue to reflect the previous termination of a more burdensome and expensive supply contract in 1999. See Berkshire Gas, D.T.E. 01-41, p. 12.; Berkshire Gas, D.T.E. 02-19, pp. 19-20. Berkshire indicated that limited quantities of gulf coast supplies would be purchased and that such gas could be purchased pursuant to attractive, flexible terms that were comparable, if not superior, to gas supply contracts available to Berkshire or the other LDCs. Berkshire Gas, D.T.E. 01-41, pp. 5, 12; Berkshire Gas, D.T.E. 02-19, p. 20; Berkshire Gas, D.T.E. 98-110, pp. 5-6; Boston Gas Company, D.T.E. 99-76, p. 21 (1999); Berkshire Gas, D.T.E. 99-81, p. 4 (1999); NOI - Gas Unbundling; D.T.E. 98-32-B, pp. 59-60. The Purchase Agreement also reflected an enhancement from the Agreements whereby the Company now enjoys greater flexibility in the purchasing of its gulf coast supplies. Exh. BG-1, p. 10; Exh.

BG-3, Art. 2.7; cf. Exh. AG-1-2. The Purchase Agreement also helps the Company to maintain reliability in view of the resources of BP Energy, the largest producer and reserves holder of natural gas in North America. Exh. BG-1, p. 9; Exh. DTE-1-6. The Purchase Agreement also contains favorable contractual provisions, e.g. the force majeure clause. Exh. BG-3, Art. XIV; Cf. Berkshire Gas, D.T.E. 01-41, p. 5.

In sum, the Purchase Agreement furthers Berkshire's portfolio objectives of implementing a least cost supply strategy that maximizes flexibility and reliability and, therefore, is consistent with the public interest. Exh. AG-1-44; Berkshire Gas, D.T.E. 01-41, pp. 11-12; Berkshire Gas, D.T.E. 02-19, p. 20, see also Commonwealth Gas Company, D.P.U. 94-174-A, p. 27 (1996); Berkshire Gas Company, D.T.E. 98-99, pp. 38-39 (1999) (Berkshire's supply planning process seeks the development of a resource plan that provides safe and reliable service, including efforts to minimize short-term costs while maintaining long-term supply security); Berkshire Gas, D.T.E. 98-110, pp. 4-5; Berkshire Gas, D.T.E. 02-17, pp. 24-25. Accordingly, Berkshire has demonstrated that the execution of the Purchase Agreement, similar to earlier versions of this alliance agreement, provides net benefits to customers and satisfies the Department's standards with respect to gas purchase agreements. Berkshire Gas, D.T.E. 01-41, p. 12; Berkshire Gas, D.T.E. 02-19, p. 20.

B. Benefits of the Agreements

1. The Company Maintains Full Control Over Its Assets Under the Portfolio Agreement.

Under the Portfolio Agreement, the Company will continue to control, own and operate its natural gas portfolio while accessing and leveraging BP Energy's extensive resources. Exh. BG-1, p. 9; Exh. AG-1-16. Importantly, many of these specific contracts have been approved by the Department and the overall resource plan has been considered and approved in the forecast and supply plan review. Berkshire Gas, D.T.E. 02-17; see, also Berkshire Gas, D.T.E. 01-41, p. 11; Berkshire Gas, D.T.E. 02-17; Berkshire Gas, D.T.E. 98-99. The Portfolio Agreement continues to provide the Company with the flexibility to manage its gas supply and procurement activities for the benefit of the Company and its customers. Exh. BG-1, p. 9; Exh. BG-3, Art. II.

Berkshire will continue to maintain control of its dispatch decisions on a daily basis, as it has always done. Berkshire will continue to review weather forecasts, evaluate load requirements, storage inventories, market conditions, and conditions on the Tennessee Gas Pipeline to determine its dispatch requirements. Exh. DTE-1-16. Reviewing these wide range of factors will enable Berkshire to continue dispatching gas to its customers on a least-cost basis. Once Berkshire completes this analysis, Berkshire will continue to participate daily with the alliance team to review how much gas is required for the day and to discuss opportunities available to optimize the portfolio. Exh. AG-1-17; Exh. AG-1-22 (Att. B, pp. viii-ix). If necessary or appropriate, follow-up calls may be conducted during the course of the day. Exh. AG-1-22 (Att. B, pp. viii-ix). Berkshire will remain able to monitor and review transactions on a daily basis to ensure that the needs of its customers are being carried out. Id. at viii-x. This monitoring and reviewing capability will ensure that Berkshire's customers are being provided with least-cost gas and the maximum optimization or capacity management opportunities available to them while maintaining reliability.

The Portfolio Agreement implements an alliance structure that remains fully consistent with and enhances the Company's traditional gas supply strategy and portfolio objectives. Exh. DTE-1-3; see Berkshire Gas, D.T.E. 01-41, pp.

11-12. Berkshire Gas, D.T.E. 02-19, pp. 16-17; Berkshire Gas, D. T. E. 99-110; Berkshire Gas, D.T.E. 02-17, pp. 36-37; Berkshire Gas, D. T. E. 98-99, pp. 38-39. Under the Portfolio Agreement, the Company will: (i) retain full control of and access to its current gas supply, transportation and storage assets, as well as all downstream resources such as liquefied natural gas; (ii) have continued access to pricing under existing lower priced supply contracts; and (iii) purchase gas at production area pricing indices, without any requirement to use market area pricing indices. Exh. BG-1, pp. 10-11; Exh. B-3, Exhibit B-2. In sum, the alliance has been structured to maximize benefits in a variety of market conditions consistent with the Company's portfolio objectives. See Exh. BG-3, Art. IV; Berkshire Gas, D.T.E. 02-19, p. 17, n. 13; Tr. 22 (Alliance has performed well in declining market conditions).

Accordingly, the Department should find that the continuation of the alliance pursuant to the terms of the Agreements is consistent with the public interest.

2. The Portfolio Agreement Provides the Maximum Opportunity for Savings.

The record demonstrates beyond challenge that the Agreements and the alliance structure reflected therein provide the most meaningful opportunity for generating the maximum level of savings or benefits for customers, particularly when optimization or capacity management is most necessary or beneficial. The Agreements maintain a guaranteed minimum payment. Exh. BG-1, Art. IV; Exh. BG-1, p. 9. Further, the merits of securing an alternative structure such as an asset manager are increasingly diminished. The increasing depth and breadth of Berkshire's and the LDCs' experience suggests that there should be a sharing of optimization benefits and less of a need, for example, to "turn over the keys" to an asset manager. In addition, such asset management arrangements provide greater risk given the assignment of control to third parties at a time of decreasing financial stability of asset managers. Exh. BG-1, p. 6; Tr. 56. In sum, the Agreements are likely to provide benefits to the Company equivalent to the best alternative bid even when market conditions are not favorable. Alternatively, when greater optimization opportunities arise, the alliance will result in substantially greater benefits for customers as the Company and the LDCs' retain nearly all of the valuable "upside" on savings. Exh. BG-3, Art. IV; Berkshire Gas, D.T.E. 02-19, p. 14.

Berkshire has determined, based upon the extensive analysis performed in the RFP process, that the alliance structure provides the greatest "overall" opportunity for the Company to fulfill its portfolio objectives and the directives of the Department in D.T.E. 98-32. Berkshire respectfully submits that the analysis of the prospect of various outcomes and the relative opportunities performed in the RFP process that resulted in the decision to maintain the alliance structure with BP Energy was an exercise in effective and prudent resource planning. Accordingly, the Department should find that the alliance structure continues to provide the best opportunity for the Company to secure a least-cost gas portfolio for the benefit of customers.

3. The Portfolio Agreement Imposes No Additional Risks on the Company or Its Customers.

The Portfolio Agreement requires that the purchase price of natural gas will be at the lowest available marginal commodity cost. Exh. BG-3, Art. XII. By its very terms, the Portfolio Agreement ensures that the Company pays no more for natural gas under the Portfolio Agreement than they would have in the absence of the Portfolio Agreement. Exh. BG-3, Art. XII, Exhibit B-2. As such, the Portfolio Agreement places no additional market risk on the Company or its customers. This feature was significant to the Department in its review of the 2001 Agreements and has been retained in the Agreements. See Berkshire Gas, D.T.E. 01-41, pp. 11-12; see also Berkshire Gas, D.T.E. 02-19, p. 16.

The Purchase Agreement provides that the Company will purchase natural gas at production area indices chosen by the Company - - a pricing methodology consistent with the Company's historical practice and accepted portfolio objectives. Id. The use of these market-based indices will ensure that gas is purchased on terms at least as favorable as the range of alternatives reasonably available to the Company. Commonwealth Gas Company, D.P.U. 94-174-A, p. 27. This approach, coupled with BP Energy's strong presence in the natural gas market described above will also maintain the Company's stellar reliability record. Exh. DTE-1-2. The Agreements also provide for greater purchasing flexibility for Gulf Coast gas by the Company than in the 2001 Agreements. Exh. BG-3, §2.7; Exh. BG-5, §5.3.

In addition, consistent with the fact that the Portfolio Agreement imposes no additional risks on the Company or its customers, the Company will not engage in any speculative financial arrangements under the Portfolio Agreement. Exh. BG-3, Exhibit B-3. While certain methods of reducing the cost of gas, such as injecting gas into storage during traditionally low cost months and withdrawing at average cost during winter months, as well as other physical transactions, may be deemed to be "hedging," they are, in fact, traditional cost reduction methodologies used by utilities to reduce the cost of gas to customers. These transactions are the means by which "savings" are secured. The Company will continue to comply with the relevant directives of D.T.E. 02-19 and D.T.E. 01-41 with respect to such matters.

4. Alliance Procedures and Contracts That Were Appropriate and Reasonable Have Been Somewhat Enhanced.

The Company recognized that the alliance structure was complex and required substantial diligence in terms of the calculation of savings achieved as a result of alliance activity as well as the allocation of such savings among the Company and the LDCs. The Company and the LDCs implemented and have refined substantial procedures and controls with BP Energy to ensure that transactions were executed properly, that savings from alliance transactions were calculated properly and that savings were allocated properly. Exh. BG-3, Exhibits B-2, B-10; Exh. DTE-1-25 (Supp.). The Company believes that the results of the alliance activities for the past three years demonstrate that the initial procedures and controls were satisfactory. Exh. DTE-1-25 (Supp.); Berkshire Gas, D.T.E. 02-19, p. 14-15.

Specifically, the record demonstrates that transactions were executed on a daily and monthly basis without problem, reliability was maintained, if not enhanced, initial savings estimates that were later reconciled to relevant invoices were accurate and the Company and the LDCs benefited from sound procedures and reports. Allocations to the Company and the LDCs were also made appropriately. Exh. DTE-1-25 (Supp.).

Indeed, as part of the process of completing the second term of the alliance, i.e. the 2002 Agreements, the Company and the LDCs commissioned a comprehensive audit of alliance procedures and controls. An experienced internal audit team was organized. This cost-effective internal audit generally confirmed what the alliance team had already recognized. First, the procedures and controls at BP [Energy] continue to be "reasonable and are functioning as intended". Exh. DTE-1-25 (Supp.). The audit process also confirmed that savings calculations were made as intended and payments between BP Energy and Berkshire and the LDC's were made in accordance with the 2002 Agreements. Id.

The Company and the LDCs also shared (and have already addressed) some of the same limited concerns of the auditors. First, the Company recognized the need for more timely and complete documentation of alliance activity. Accordingly, the Operating Procedures Agreement was revised even prior to the issuance of the auditor's report to include many of the specific enhancements suggested by the audit team. Exh. AG-1-22 (Att. A); Exh. DTE-1-25 (Supp.). The auditors later confirmed this concern in the audit report. Exh. DTE-1-25 (Supp.). Berkshire is confident that the negotiated enhancements to reporting procedures will only enhance an already satisfactory process.

In sum, the Agreements reflect enhanced terms and conditions. Specifically, reporting procedures will remain more detailed and allocation activities will be done on a more regular basis. The alliance team also will benefit from the past years' working experience in terms of not only optimization strategy, but also reporting and coordination requirements. Accordingly, the Department should recognize these enhanced procedures and find that the procedures and controls to be implemented pursuant to the Agreements are reasonable and appropriate.

C. The Agreements are Consistent with Statutory Obligations and Satisfy Relevant Precedent

The Company has demonstrated that, similar to the 2001 Agreements and the 2002 Agreements: (i) the Portfolio Agreement satisfies the Department's standards under G.L. c. 164, §94A and G.L. c. 164, § 76 and, therefore, the Department's findings in NOI-Gas Unbundling, D.T.E. 98-32-B; and (ii) the related

Purchase Agreement satisfies the Department's standards under G.L. c. 164, § 94A. Berkshire is proud of the efforts it has undertaken with the LDCs to implement and refine a strategy that responds to Department directives and advances the opportunity to secure the greatest value for customers. Berkshire is pleased to have secured such an attractive deal given volatile market conditions and diminishing opportunities. In addition, Berkshire believes that substantial long-term benefits will inure to the Company through its continuing participation in the alliance in the form of greater market awareness and expertise. While more difficult to quantify, these benefits are expected to be real and substantial. Berkshire looks forward to working with the LDCs and BP Energy to managing its resources in order to secure savings for its customers and remains committed to the pursuit of a least-cost gas resource portfolio. Accordingly, the Department should find that the Agreements are consistent with Berkshire's statutory obligations and are consistent with substantial and direct Department precedent.

V. THE COMPANY'S PROPOSAL FOR SHARING OPTIMIZATION MARGINS IS APPROPRIATE AND CONSISTENT WITH DEPARMENT PRECEDENT

Ms. Zink's testimony described the Company's proposal for the treatment of margins generated as a result of optimization transactions such as capacity release ("CR") and off-system sales ("OSS") executed within the context of the alliance. Specifically, the Company demonstrated that the Company is pursuing the very type of transactions defined in the "categories" established in Interruptible Transportation, D.P.U. 93-141-A (1996). Exh. AG-1-58. Thus, the Company proposes to track these transactions by category and, consistent with established margin sharing practices, retain twenty-five percent (25%) of the amount that annual savings for a particular “category” exceeds the Company’s performance in the prior year. Exh. BG-1, pp. 11-12.[9]

Berkshire described how the Department’s margin sharing precedent provides a strong and appropriate incentive to local distribution companies, such as Berkshire, to be aggressive in optimizing its resource portfolio for the benefit of customers. Exh. BG-1, p. 12; Exh. AG-1-60. Indeed, the Department has encouraged local distribution companies to “consider seriously more aggressive capacity release.” Interruptible Transportation, D.P.U. 93-141-A, p. 61. Berkshire has worked aggressively and creatively to establish the alliance that maximizes the overall benefit to customers.[10] Berkshire respectfully submits that the opportunity to share margins is an appropriate reward for its aggressive pursuit of optimization opportunities. In fact, the denial of Berkshire’s request would effectively punish Berkshire relative to other utilities that have not pursued such savings as aggressively. The Department has in fact applied margin sharing to other creative opportunities for the generation of margins. See Boston Gas Company, D.T.E. 99-76 (1999); RR-DTE-1. In sum, as stated in Ms. Zink’s testimony, the Department should find that its established margin sharing principles “apply to the transactions pursued by Berkshire with the assistance of its alliance participants and approve its margin sharing proposal of assigning alliance transactions to the Department’s established categories or, alternatively, consider alliance savings on an aggregate basis.” Exh. BG-1, p. 12.

[9] The Company also presented an alternative proposal, namely apply the established 25/75 split on increased savings to the alliance structure on an aggregate basis. Exh. BG-1, p. 12.

[10] Berkshire discussed a similar proposal in its briefs in D.T.E. 02-19. The Department’s decision rejected the request as not timely but indicated that it would remain open to consider a separate petition for cost recovery of margins generated pursuant to the 2002 Optimization Agreements. Ms. Zink explained that such a separate filing could not be justified on a cost basis. Tr. 143-144. Accordingly, the Company requested such treatment in this proceeding with respect to the Agreements.

VI. CONCLUSION

In summary, the Company has demonstrated that the Portfolio Agreement will provide benefits to Berkshire's customers in the form of lower gas costs while enabling Berkshire to continue to provide safe, reliable service. Based on the foregoing, the Company respectfully requests that the Department take such actions as may be necessary and appropriate and issue an order approving the Agreements pursuant to G.L. c. 164, §§76 and 94A. Finally, the Company respectfully requests that the Department accept the Company's proposal to treat margins generated pursuant to the Portfolio Agreement consistent with the principles anticipated in Interruptible Transportation, D.P.U. 93-141-A (1996).

Respectfully submitted,

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